DEPARTMENT OF INFRASTRUCTURE ENERGY & RESOURCES

METRO SUBMISSION COMMENTS

Return on capital/profit vs "break-even funding" (part of Section 4.3)

Metro is not funded to achieve a commercial profit and, as is the case for most public transport operators, it relies heavily on Government funding support. The current Community Service Agreement (CSA) Agreement is based on "deficit funding" which enables Metro to fill the gap between what Metro receives through its various revenue sources and the anticipated costs incurred for providing the current level of service. The CSA payment acts to subsidise concession fares and maintain services and routes that are otherwise non commercial.

Put simply, if a "commercial return on equity" is accepted as a cost that must be met up front by Government, then the Government would be obliged to increase the level of CSA funding by a comparable amount (estimated at over $2 million for 2003/04).

Although it is accepted that commercial businesses competing in a market need to achieve sustainable returns on capital and equity in order to demonstrate their commerciality and provide economic justification for their activities and investments, the Department of Infrastructure, Energy and Resources (DIER) believes it is unnecessary for the Government to provide an automatic return on capital to Metro so that it can be declared as a dividend later on. Thus, while DIER agrees that there is a need to calculate and take into consideration a commercial rate of return for the purposes of accurate benchmarking, it believes that this calculation can be made without an actual transfer of funds occurring.

Whilst dividends and other financial ratios may be used, in part, to judge the performance of other Government businesses, they do not provide a useful range of performance indicators in respect to Metro's circumstance. The measurement of Metro's performance in respect of shareholder expectations is better served by performance indicators that focus on Metro's service delivery and its efficiency levels compared with other providers of public transport in metropolitan areas.

Effectiveness of Metro's service delivery (Section 8)

DIER accepts that it was agreed that Metro's effectiveness should be measured against "Shareholder Expectations", as stated in Metro's Annual Report. In effect, any measures or indicators of Metro's effectiveness should address the questions: 'How well do Metro's services meet the travel needs of the main client groups?' and 'How good is Metro in relation to providing customer service and quality in service delivery to its main client groups?'

The main client groups are defined as students travelling to and from school, commuters travelling to and from main employment centres (within the metropolitan areas) and "general mobility for those without access to private travel means".

In this context, DIER accepts that 'first boardings per bus kilometre' is a good indicator of Metro's output effectiveness and that the higher the level of occupancy of the seats provided, the better Metro are doing in matching services to the community's travel needs.

DIER acknowledges that Metro, like all other metropolitan public transport providers, is experiencing a long-term decline trend in patronage, and that the factors for this trend are largely outside of Metro's influence. Nevertheless, we are unsure that the "correct base line" for assessing effectiveness should be the long-term trend. DIER would contend that the level of "first boardings per bus kilometre" should be compared against the levels achieved in the previous year as well as against the long-term trend for patronage -- if only to identify whether the differences are better or poorer than might be expected solely from the long-term trend.

In conjunction with the use of "first boardings per bus kilometre" as a global indicator of effectiveness, it is also important to have indicators of the degree to which the needs of <u>each</u> of the main client groups are being met. It is understood that Metro collect data to show the degree to which the level of patronage of its main client groups has increased or declined relative to the other groups over time. This data provides an indication of whether the main groups are taking up more, or less, of the seats that are available to them. However, it is acknowledged that Metro will need to analyse the specific reasons that impact on each client group if it is to effectively address higher than expected declines in patronage from particular client groups. But, as observed earlier, many of these factors may be beyond Metro's influence.

At another level, Metro's effectiveness in meeting the transport needs of its main client groups, might also be assessed by determining the degree to which Metro's services are targeted at those in the community who have the highest level of need for public transport. DIER, with the support of Metro Tasmania, has recently commissioned a comprehensive analysis of the distribution of public transport need across the Greater Hobart area. Our consultants, Booz Allen Hamilton, have used a number of social and economic criteria to measure the need for public transport in each census collector district in the greater Hobart area. Each collector district has been awarded an index score to indicate the level of "total transport need" in that district, while another index score has been calculated to indicate the level of "relative transport need" in each area. These indices provide a means by which a comparison can be made of the level of total and relative need for public transport in each census collector district.

The study is currently continuing into its second stage, which is a detailed measurement of the level of supply of public transport provided by Metro in each of the collector districts within the Hobart area. The final report will provide a "gap analysis of transport need in the greater Hobart area". The report will indicate those areas where there is a gap between the level of need for public transport and the level of supply.

This work has the potential to identify additional indicators for measuring Metro's effectiveness, and will assist Metro's Shareholders to further refine the social objectives and client groups that Metro is to serve. The study has the potential to assist the Government to better define the outcomes it wishes Metro to achieve, and can help provide guidance for any proposals for "minor" or "major changes" in Metro services.

In their submission, Metro complained that DIER has provided them with no recent support as to the direction public transport should be taking in Burnie, Launceston and Hobart. This

complaint ignores the fact that an independent review of metropolitan services was announced in 2000, with a finish date set at June 2005, and that the current approach to services are constrained by the level of Government funding provided for in the current CSA Agreement.

The results of DIER's current major study will enable DIER to develop minimum standards for Metro services in metropolitan areas and develop a policy framework that the Government can apply when assessing proposals for changes to Metro services.

DIER notes that Metro's submission claims that changes to Metro services largely occur by Metro accepting responsibility for operational planning and responding to events in the community at large. DIER agrees with Metro that this demonstrates Metro's responsiveness to changing public demands; and would argue that operational planning at this level should be the responsibility of the service provider.

However Metro's claim that "since the commencement of the *CSA Agreement* in 1997, there have been no changes to services initiated by DIER is contradicted by the submission's own subsequent reference to the major change initiated by DIER for the inclusion of Ravenswood in the network in 2000.

The use of "complaints per million first boardings", and "performance against the customer service charter" are accepted as appropriate indicators of Metro's effectiveness in focussing on customer needs and the quality of their service delivery**.**

DIER considers that Metro's proactive approach to the introduction of the Disability Discrimination Act (DDA) compliant buses is to be commended. DIER shares Metro's belief that accessible buses are also attractive to the wider public and that they have a role in expanding Metro's markets.

DIER notes the importance of "on-time performance" and "early running" as critical issues for current passengers and potential passengers. The implementation of an GPS-linked ticketing system will enable closer monitoring of actual on-time performance and the fine-tuning of timetables.

However, variation of travel speeds between peak periods and between school terms and school holidays will continue to influence the arrival and departure times at bus stops en route. DIER accepts that these matters are not easy for Metro to deal with and are often outside of their control. However, it might be possible for Metro to consider alerting passengers to the effect that school holidays may have on running times, and explore small scale strategies to minimise the variations.

In regard to other measures for increasing Metro's effectiveness and responsiveness to the public, DIER supports the list of measures identified by Booz-Allen Hamilton in their report for Metro entitled "Proposed Patronage Enhancement Initiatives". DIER also agrees that there is a range of external influences that directly impact on demand, and which Metro has no control over. Booz-Allen Hamilton refer to these influences as "Government and Community Issues - Metro Policies". These issues include Land Use Planning, General Transport Policy (especially car parking policy), Bus Regulatory Reform, Infrastructure Provision and Local Council Liaison and Consultation. All of these elements have a material impact on influencing demand for public transport and affecting the potential for developing a public transport culture in Tasmania.

CSA Agreement and incentives (Section 9)

DIER does not accept that the current CSA Agreement represents a "straight jacket" which prevents Metro from pursuing opportunities for building patronage, nor does DIER accept that the structure and intent of the current CSA Agreement is inappropriate.

Under the current CSA, Metro has the freedom to initiate and implement "minor changes" and put up proposals for "major changes". Definitions of minor and major changes are provided in the contract. With regard to minor changes, DIER's involvement or intervention in service design is not required. With regard to major changes where major groups will be affected and or increases in CSA funding will be required, it is appropriate that DIER and the Government are consulted.

Metro's submission suggests that the Government's concern to achieve precision over budget allocations is misplaced, and that greater social good/Government policy outcomes might be delivered if top-up incentives were paid to Metro for every concession passenger and every extra commuter passenger carried.

The Government's concern to be precise about budget allocation, is properly based on a desire to ensure that budget outlays for a financial year are foreknown. If, as is currently the case, Treasury wishes to ensure that Metro delivers improved efficiencies, then the specification of a budget allocation for the year also becomes the mechanism for ensuring that Metro strives to achieve that efficiency target.

It is also difficult to understand why the retention of fares, as is the case now, should not be a sufficient incentive for Metro to grow patronage. Indeed, their submission is replete with examples of the steps they are taking to optimise patronage and make public transport more attractive. Correctly, they have identified a number of crucial external factors that are outside of their control, and yet they argue that the most significant factor is the lack of a direct incentive for them to go out and chase patronage.

The current CSA payment is calculated at the commencement of the contract on a presumed patronage level and cost structure. Clearly if Metro is to increase their patronage over the term of the contract, there is the potential to generate a profit. Similarly, if Metro creates efficiencies over the term of the contract and creates cost savings there is a capacity to generate profits.

If a per passenger system of subsidising the CSA contract was introduced, the subsidy paid by the Government would be calculated around a presumed level of patronage and cost structure. Clearly, if the level of patronage and the cost structure remains the same, Metro’s operating performance has not improved. Therefore, any “profit” that resulted would be artificial because it would be a product of an increased subsidy from the Government as a result of the new funding arrangement, not the commercial acumen and performance of Metro.

The introduction of a top-up based payment system would also result in increased administrative costs for both DIER and Metro.

Regardless of the method by which the CSA is calculated, the real incentive for Metro should be increasing the level of patronage on their services and ensuring services are provided as efficiently as possible. There are means by which this performance can be measured in either financial terms, or key performance indicators without the need for altering the basis or means by which Metro is funded.

It is understood that per passenger subsidies are being widely promoted by the Bus Industry Confederation, and advocates, such as Professor Henscher as an effective mechanism by which suppliers of mass transport systems in metropolitan areas can be given the flexibility to vigorously pursue growth in modal share vis a vis the private car. The attractiveness of increased patronage for public transport in urban areas with growing traffic congestion and high levels of noise and pollution is undoubted. However, it is not clear that these problems are yet a high priority for Tasmanian cities.

A decision to move to a system whereby per passenger incentives are provided to Metro, should only be taken in a situation where the Government identifies urban traffic congestion as a policy priority, and is prepared to pay significantly more for operators to achieve patronage growth. In the current situation where traffic congestion is a relatively minor issue, there are no compelling reasons to alter the CSA funding allocation set for the year.

Whilst a top-up arrangement may assist Metro to design its services around recovering the marginal cost of operating a service, this objective may in many cases be contrary to the social objectives assumed within the Government's Community Service Obligation, but it is accepted that the current policy framework does not provide Metro with clear enough guidelines with which to identify the relative priority of individual services.

As stated earlier in relation to indicators of Metro's effectiveness and responsiveness, the work currently being completed by DIER's external consultants will assist the Government to better define the relative priories of its social objectives and better support decisions about when service provision should be withdrawn or extended.

DIER's experience with regional, fare-paying student services which depend on per passenger top-up funding, shows that such funding arrangements can distort service delivery to the point that some communities receive a door to door service far in excess of the level of service provided in metropolitan areas served by Metro. It is questionable whether it would be a desirable outcome for Metro to have incentives that encourage them to replicate the situation that has developed in some regional centres.

Penalties and Bonuses

The inclusion of a liquidated damages clause was strongly opposed by Metro in the negotiations for the current CSA Agreement -- even though a liquidated damages clause appears in the contracts that DIER has with private operators.

Apart from the contention that Metro’s payment structure does not include a profit margin from which damages could be paid, the objections Metro raised in regard to the introduction of liquidated damages provisions are no less relevant for private operators.

Metro opposed the introduction of liquidated damages partly on the grounds that it was concerned damages might be applied in circumstances where the events were beyond Metro's control. However, in recognition of this possibility, DIER agreed in negotiations to place a 'Force Majeure clause' in the CSA agreement, as is the case with the contracts that DIER has with private operators.

Placing bonus payments in the contract for on-time performance above accepted norms and service cancellation levels below a negotiated norm should only be adopted if the contract were priced on the assumption that the level of performance is expected to be insufficient or incomplete and incentives are required to improve on this expected result.

If, however, the contract were structured on the basis to 100% compliance, then clearly it would be unreasonable to pay a bonus for the required level of performance. Contracts with private operators are structured with 100% compliance anticipated; while any failures will result in the imposition of liquidated damages, on the basis that the Contractor has failed to provide the service they are being paid to supply.

The notion of Metro receiving a bonus for providing an average fleet age lower than the accepted norm and/or a higher number of DDA vehicles has some merit given the need to recognise the higher capital cost and the higher level of service to passengers. In considering this option and calculating any bonus, it would have to be noted that Metro would already be receiving the advantage of a more attractive service presumably resulting in higher patronage and the lower running and maintenance costs associated with newer vehicles.

Integration of Public Transport Systems (Section 8.8)

DIER is actively supporting and contributing to Metro's plans to introduce a new system of electronic ticketing as a means to increase the degree to which passengers can use the same smart-card for travel on the services provided by different operators.

DIER has developed a search engine which will be available on a website that will be a central source of information for school and general access bus services in regional areas. Using a simple map-based interface, users will be able to view timetables for services on particular routes. Where available, the website will link directly to operators' timetables provided on the web, ensuring the timeliness of the information.

DIER, in consultation with Tourism Tasmania, has also established on the *Discover Tasmania* website linkages to regional bus service timetables. Further development of this facility is currently under way to meet the specific needs of interstate and international travellers to Tasmania.

DIER is currently acting to finalise contractual arrangements for core services in regional areas prior to commencement of the review of core services that is to required under the provisions of the *Passenger Transport (Transitional) Regulations 2000*. Prior to entering into the pre-review "interim contracts", DIER seeks to identify any opportunities to improve service integration. However, DIER believes that it will be the role of the review process itself to closely scrutinise ways in which service interconnectivity and integration can be improved at the local and regional level.

Student Concession fares (Sections 2.4 and 5.4)

Metro's submission correctly identifies a number of differences in the nature of student fares -- Metro student fares are set at a flat rate of $1.20; while private operators charge 30 cents (regional services) or 70 cents (intra metropolitan services) for journeys that may be considerable longer than the Metro trip. The gap between these fares influenced Government's decision not to increase the Metro student fare at the time of the previous Government Prices Oversight Commission (GPOC) report, despite GPOC's recommendations that the fare should be increased in response to Metro's increasing costs.

DIER considers that there would be merit in investigating the justification for a child fare set at 50% of the full adult fare, for children who are not travelling to and from school and who are not eligible for a free pass.

DIER also agrees that there is need to consider how anomalies in student and concession fares might be addressed and how eligibility for concession passes is determined vis a vis other jurisdictions. However, DIER believes Metro's proposals are not fully presented and has some difficulty in determining whether Metro is proposing distance-related fares for concession and student passengers, set at 50% of the full adult fare. If this is the case, it is difficult to understand Metro's claim on page 53 that the adoption of a distance-based, 50% concession fare would promote achievement of shareholder expectations in regard to its main clients.

DIER believes there is merit in investigating the strategies to achieve greater equity into user contribution to fares across urban and non urban areas, but believes that any changes would need to carefully consider the impact on the main client groups and any funding implications for Government.

Metro Index (Section 10)

DIER accepts that Metro has identified a number of problems with components of the Metro Index (established to reflect changes in Metro's input costs and trigger quarterly adjustments to the CSA Agreement and determine whether maximum fares might be increased).

As previously communicated in correspondence to Metro and GPOC, DIER supports Metro's request that GPOC assess a number of specific problems and provide comment on the modifications that Metro wishes to propose.

DIER also accepts that the "practical difficulties" that Metro refers to in 10.2 of its submission should be addressed by formal adjustments to the Index.

In relation to 10.3.1, DIER notes that the ABS index that Metro originally selected as an the index for showing changes in their labour costs has not matched the actual labour cost increases experienced by Metro in the past 18 months. DIER supports Metro's request that GPOC assess the merits of utilising the approach adopted by the Victorian Department of Infrastructure (ie. adjust the labour sub index by references to changes in the average weekly earnings applicable for Tasmania, based on full time ordinary earning --trend series.)

In relation to 10.3.2, DIER would give consideration to any suggestions for changes to the definition of the diesel fuel cost index -- in order to minimise lags in the "flow through" of actual changes into the fuel index.

In relation to 10.3.3 (vehicle equipment and parts), DIER has already recommended that this issue be referred to GPOC for review.

A broad point about the School Bus Index (SBI) -- the SBI is often criticised by private bus operators and is in need of an overhaul. DIER is currently undertaking a review of the system of remuneration used for school bus contractors and is developing a new Bus Cost Model. This work will be extended to include a critical analysis of the School Bus Index and the sub-indices which are currently used to justify increases in approved fares and contract adjustments to private operators. The outcome of this work will be a indexation mechanism for the Bus Cost Model.

(Confidential Information Removed as Requested - GPOC)

Government Policy re provision of Metro bus services in the Kingston -Blackmans Bay area

DIER has consulted with Metro Tasmania to clarify the details of the Metro-level fares and services that have been proposed for the Kingston - Blackmans Bay area and for services between Kingston and Blackmans Bay.

A funding proposal has been submitted to Government for approval. The outcome of this decision will determine the commencement date of the proposed services.

Explanation of the different fares and concessions between Hobart Coaches and Metro

Metro fares and Hobart Coaches fares between Kingston and Hobart are different. The reason why Metro fares are lower than the fares of Hobart Coaches relates to the unique nature of Metro's funding and external fare control.

The fares inconsistency between Metro and Hobart Coaches is also highlighted by the fact that Metro owns Hobart Coaches, and for operational efficiencies, swaps buses between one service and the other. This may create a perception of a linkage between the two companies, and as such an expectation on fares consistency. Metro is structured as a State-owned Company and is subject to strict controls both contractually and under Corporations Law. Metro’s purchase of Hobart Coaches served to retain a service which was in risk of being withdrawn by its owners at the time; however, the purchase was only approved by its shareholders on the basis that it would return a commercial profit to Metro. Thus Hobart Coaches for all intents and purposes is treated as a private service provider.

Private service providers are funded by their shareholders and owners on the basis of achieving a commercial return, based on factors relating to their specific route(s). These factors include bus size, passenger numbers and distances travelled. DIER is responsible for approving indexation of existing fares on core Regular Passenger Transport services, in accordance with movements in the SBI Index. DIER also has the role of approving fares for new core regular passenger transport services. Fares on new services are negotiated with private operators and are based on what they require to cover their cost and patronage variables and make a commercial profit. Due to the differences found in the cost variables of private operators between one route and another, there is also a consequent variation in the fares charged.

Metro and Merseylink, stand alone in being funded by the Government by a Community Service Agreement which provides a gross sum for supporting a specified set of services within a number of metropolitan areas, as distinct from a per passenger fare subsidy arrangement by which private operators are mainly subsidized. Metro is allocated approximately $20 million annually to provide services to communities in greater Hobart, Launceston and Burnie. Metro’s funding and fares are not intended to incorporate a profit margin.

Being a monopoly service provider in the metropolitan context, Metro’s fares are set by the GPOC, which, in setting fares, takes into account a range of issues including Metro’s costs and fares relative to other State-funded metropolitan service providers throughout Australia. GPOC has already noted some disparities in Metro’s section-based fare relativities, particularly for longer trips.

Metro's suggestion (page 50) that it work with DIER and GPOC to review its fares on some of its longer trips has the potential to result in recommendations that some of Metro's longer distance fares be increased. This would close the gap between private operator fares and Metro fares for longer journeys.